

TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE



FISCAL MEMORANDUM

HB 534 – SB 1221

April 18, 2017

SUMMARY OF ORIGINAL BILL: Changes, from July 25 to July 20, the deadline for a person who operates a motor vehicle in this state that is propelled by liquefied gas or compressed natural gas to submit to the Department of Revenue an annual report with certain travel information and to remit the liquefied gas and compressed natural gas user taxes due.

FISCAL IMPACT OF ORIGINAL BILL:

NOT SIGNIFICANT

SUMMARY OF AMENDMENTS (006827, 007610): Amendment 006827 deletes all language after the enacting clause. Enacts the *Improving Manufacturing, Public Roads and Opportunities for a Vibrant Economy (IMPROVE) Act* or the *2017 Tax Cut Act*.

Increases motor vehicle registration fees for Class (A) through Class (H) vehicles by \$5.00 each. Imposes an additional motor vehicle registration and renewal fee of \$100.00 on electric vehicles. Increases registration fees for private and commercial motor vehicles operating for hire who transport passengers by \$10.00 each. Increases registration taxes for trucks and truck tractors by \$20.00 each.

Increases the gasoline tax rate from \$0.20 per gallon to: \$0.24 per gallon effective July 1, 2017; \$0.25 per gallon effective July 1, 2018; and \$0.26 per gallon effective July 1, 2019. Requires all revenue generated from the gasoline tax rate increase be allocated as follows: 25.40 percent to counties (subject to certain restrictions); 12.70 percent to municipalities; and 61.90 percent to the Highway Fund.

Deletes the local gasoline tax option, codified in Tennessee Code Annotated Chapter 67, Title 3, Part 10, which authorized municipalities and counties to levy a local gasoline tax of \$0.01 per gallon to fund public transportation systems.

Increases the diesel tax rate from \$0.17 per gallon to: \$0.21 per gallon effective July 1, 2017; \$0.24 per gallon effective July 1, 2018; and \$0.27 per gallon effective July 1, 2019. Establishes that the diesel tax rate will remain \$0.17 for diesel fuel that is indelibly dyed and used by a commercial carrier to produce power for a means of transportation, as defined in the Transportation Fuel Equity Act. Requires all revenue generated from the diesel tax rate increase be allocated as follows: 17.50 percent to counties; 8.80 percent to municipalities; and 73.70 percent to the Highway Fund.

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Increases the liquified gas tax rate from \$0.14 to: \$0.17 per gallon effective July 1, 2017; \$0.19 per gallon effective July 1, 2018; and \$0.22 per gallon effective July 1, 2019. Requires all revenue generated from the liquified gas tax rate increase be allocated to the Highway Fund.

Increases the compressed natural gas tax rate from \$0.13 to: \$0.16 per gallon effective July 1, 2017; \$0.18 per gallon effective July 1, 2018; and \$0.21 per gallon effective July 1, 2019. Requires all revenue generated from the compressed natural gas tax rate increase be allocated to the Highway Fund.

Establishes the intent of the General Assembly that all revenues derived from the increased taxes and fees imposed by the IMPROVE Act on petroleum products, alternative fuels, and motor vehicle registrations, shall be used to:

- Maintain roads and bridges on the state highway system, including the interstate highway system;
- Support economic development through the construction of transportation facilities in accordance with the State Industrial Access Act and the Local Interstate and Fully Controlled Access Highway Connector Act;
- Maintain public roads and bridges within the boundaries of the state parks;
- Support local government investment in transit programs to improve regional transit services across the state and help manage congestion along major highways;
- Assist rural transit providers in improving the efficiency of demand response services;
- Support projects and programs identified in the Department of Transportation's annual transportation improvement program; and
- Fund the development and construction of 962 projects specified in the IMPROVE Act.

Authorizes the Department of Transportation (TDOT) to recommend modifications of the project list, and requires the Department to report to the General Assembly, beginning on or before July 1, 2018, and annually thereafter, on the status of projects listed in the IMPROVE Act.

Authorizes local governments to levy a surcharge on the same privileges subject to the following taxes, if the underlying local tax on such privileges is currently being collected: local option sales and use tax; business tax; motor vehicle tax; local rental car tax; tourist accommodation tax or hotel occupancy tax; and residential development tax. Establishes maximum rates for such surcharges. Establishes that no such surcharge shall become effective unless a local government develops and adopts a transit improvement program, and unless it is approved by a majority of the number of registered voters of the local government. Defines "local government" as: any county in the state having a population in excess of 112,000 according to the 2010 federal census or any subsequent federal censuses; or any city having a population in excess of 165,000 according to the 2010 federal census or any subsequent federal censuses. Establishes that any surcharge shall be levied, collected, and administered in the same manner as the applicable underlying local tax, and authorizes the Department of Revenue (DOR) to keep an administrative fee of 1.125 percent of proceeds of any such surcharge that the Department will administer and collect. Requires revenue from the surcharge be used for costs associated with the planning, engineering, development, construction, implementation, administration, management,

operation, and maintenance of public transit system projects that are part of a transit improvement plan. Establishes that, if a transit improvement program or a public transit system project becomes unfeasible, impossible, or not financially viable, the revenue from the surcharge may be directed to and utilized for a separate transit improvement program or public transit system project, if certain conditions are met.

Authorizes taxpayers whose principal business in Tennessee is manufacturing to elect to apportion their net worth, for franchise tax purposes, and their net earnings, for excise tax purposes, by multiplying them by a fraction, the numerator of which is the total receipts of the taxpayer in Tennessee during the taxable year and the denominator of which is the total receipts of the taxpayer from any location within or outside of the state during the taxable year. This authorization applies to tax years beginning on or after January 1, 2017. Establishes that a taxpayer's principal business in Tennessee is manufacturing if more than 50 percent of the revenue derived from its activities in this state, excluding passive income, is from fabricating or processing tangible personal property for resale and consumption off the premises.

Decreases, from 5.00 percent to 4.00 percent, the state sales tax rate on the retail sale of food and food ingredients. This tax rate decrease is effective July 1, 2017.

Decreases the Hall Income Tax (HIT) rate from 5.00 percent to: 4.00 percent for tax years beginning on or after January 1, 2017; 3.00 percent for tax years beginning on or after January 1, 2018; 2.00 percent for tax years beginning on or after January 1, 2019; 1.00 percent for tax years beginning on or after January 1, 2020; and zero percent for tax years beginning on or after January 1, 2021.

Amendment 007610 deletes and replaces language of the bill as amended by amendment 006827 to further reduce the state sales tax rate on the retail sale of food and food ingredients to 3.50 percent.

FISCAL IMPACT OF BILL WITH PROPOSED AMENDMENTS:

Increase State Revenue –

\$150,663,400/FY17-18/Highway Fund

\$195,674,100/FY18-19/Highway Fund

\$240,798,500/FY19-20 and Subsequent Years/Highway Fund

\$141,000/FY17-18 and Subsequent Years/Motor Vehicle Account

Decrease State Revenue –

\$30,238,000/FY16-17/General Fund

\$316,819,600/FY17-18/General Fund

\$363,596,900/FY18-19/General Fund

\$399,196,300/FY19-20/General Fund

\$434,795,600/FY20-21/General Fund

\$470,395,000/FY21-22/General Fund

\$292,398,200/FY22-23 and Subsequent Years/General Fund

Increase Local Revenue – Net Impact –

\$35,938,400/FY17-18

\$38,561,800/FY18-19

\$41,257,200/FY19-20

\$22,456,600/FY20-21

\$3,655,900/FY21-22

\$97,659,100/FY22-23 and Subsequent Years

Other Fiscal Impact – Secondary economic impacts may occur as a result of this bill. Due to multiple unknown factors, fiscal impacts directly attributable to such secondary impacts cannot be quantified with reasonable certainty.

Subsequent increases in state and local government revenue and state and local government expenditures are possible as a result of the Act’s authorization for local governments to impose tax surcharges upon voters’ approval. Such subsequent fiscal impacts cannot be determined with reasonable certainty and are not accounted for in this fiscal analysis.

The Governor’s proposed budget for FY17-18 recognizes a recurring increase in state revenue to the Highway Fund of \$278,570,000, on page A-12, and a recurring decrease in state revenue to the General Fund in the amount of \$207,756,000, on page A-38. The proposed budget further recognizes, on page A-28, a one-time decrease in General Fund revenue in FY16-17 in the amount of \$30,200,000.

Assumptions related to the motor vehicle registrations:

- Based on data provided by the DOR, it is estimated that, as of August 1, 2016, there were approximately 5,223,790 motor vehicles whose registration fees will increase by \$5.00 pursuant to this Act, 5,160 vehicles whose registration fees will increase by \$10.00 pursuant to the Act, and 385,239 vehicles whose registration fees will increase by \$20.00 pursuant to the Act.
- The recurring increase in state revenue to the Highway Fund is estimated to be \$33,875,330 $[(5,223,790 \times \$5.00) + (5,160 \times \$10.00) + (385,239 \times \$20.00)]$.
- Pursuant to Tenn. Code Ann. § 55-4-113(b), a 2.50 percent safety inspection fee is imposed upon vehicle registration taxes for certain freight motor vehicles registered pursuant to Tenn. Code Ann. § 55-4-113. These funds are allocated to the Department of Safety’s Motor Vehicle Account.
- The safety inspection fee is estimated to apply to 282,000 vehicles; the resulting recurring increase in revenue to the Motor Vehicle Account is estimated to be approximately \$141,000 $(282,000 \times \$20.00 \times 2.50\%)$.

Assumptions related to the electric motor vehicle fee:

- There are approximately 2,500 electric motor vehicles currently registered in Tennessee. This number is assumed to remain constant in subsequent years.

- The additional \$100 motor vehicle registration and renewal fee will be imposed on electric vehicles only; hybrid-electric vehicles will not be subject to the fee.
- The resulting recurring increase in state revenue to the Highway Fund is estimated to be \$250,000 ($2,500 \times \100).
- The additional fee will not have a significant impact on the number of electric passenger motor vehicles registered in Tennessee.

Assumptions related to the gasoline tax:

- The current Fiscal Review Committee staff estimate for gasoline tax collections in FY17-18 is \$684,400,000. This number is assumed to remain constant in subsequent years under current law.
- Increasing the gasoline tax rate as outlined in the proposed legislation is estimated to result in an increase in gasoline tax collections of: \$136,880,000 in FY17-18 [$(\$684,400,000 / \$0.20) \times \0.04], of which \$84,728,720 will be an increase to the Highway Fund and \$52,151,280 will be an increase to the local government; \$171,100,000 in FY18-19 [$(\$684,400,000 / \$0.20) \times \0.05], of which \$105,910,900 will be an increase to the Highway Fund and \$65,189,100 will be an increase to the local government; and \$205,320,000 in FY19-20 and subsequent years [$(\$684,400,000 / \$0.20) \times \$0.06$], of which \$127,093,080 will be an increase to the Highway Fund and \$78,226,920 will be an increase to the local government.
- Quantity demanded for gasoline will not decrease significantly as a result of the gasoline tax rate increases.
- Deleting the local gasoline tax option, which authorized counties and municipalities to levy a local gasoline tax of \$0.01 per gallon to fund public transportation systems, will not result in a significant impact to local revenue as no local government has used this authority.

Assumptions related to the diesel tax:

- The current Fiscal Review Committee staff estimate for motor fuel tax collections in FY17-18 is \$183,300,000. Based on historical collection patterns, 99 percent, or \$181,467,000, of total motor fuel tax collections is estimated to be revenue from the \$0.17 diesel tax. This number is assumed to remain constant in subsequent years under current law.
- Increasing the diesel tax rate as outlined in the proposed legislation is estimated to result in an increase in diesel tax collections of: \$42,698,118 in FY17-18 [$(\$181,467,000 / \$0.17) \times \0.04], of which \$31,468,513 will be an increase to the Highway Fund and \$11,229,605 will be an increase to the local government; \$74,721,706 in FY18-19 [$(\$181,467,000 / \$0.17) \times \0.07], of which \$55,069,897 will be an increase to the Highway Fund and \$19,651,809 will be an increase to the local government; and \$106,745,294 in FY19-20 and subsequent years [$(\$181,467,000 / \$0.17) \times \$0.10$], of which \$78,671,282 will be an increase to the Highway Fund and \$28,074,012 will be an increase to the local government.
- Quantity demanded for diesel fuel will not decrease significantly as a result of the diesel tax rate increases.

Assumptions related to the liquified gas tax:

- Liquified gas tax collections were approximately \$97,000 in FY15-16, and are estimated to be approximately \$100,000 in FY17-18 and subsequent years under current law.
- Increasing the liquified gas tax rate as outlined in the proposed legislation is estimated to result in an increase in liquified gas tax revenue to the Highway Fund of: \$21,429 in FY17-18 [$(\$100,000 / \$0.14) \times \0.03]; \$35,714 in FY18-19 [$(\$100,000 / \$0.14) \times \0.05]; and \$57,143 in FY19-20 and subsequent years [$(\$100,000 / \$0.14) \times \$0.08$].
- Quantity demanded for liquified gas will not decrease significantly as a result of the liquified gas tax rate increases.

Assumptions related to the compressed natural gas tax:

- Based on volatile historical tax collections data, it is estimated that compressed natural gas tax collections in FY17-18, under the current tax rate of \$0.13 per gallon, will be equal to the actual collections in FY15-16, or \$1,384,000. This number is assumed to remain constant in subsequent years under current law.
- Increasing the compressed natural gas tax rate as outlined in the proposed legislation is estimated to result in an increase in compressed natural gas tax revenue to the Highway Fund of: \$319,385 in FY17-18 [$(\$1,384,000 / \$0.13) \times \0.03]; \$532,308 in FY18-19 [$(\$1,384,000 / \$0.13) \times \0.05]; and \$851,692 in FY19-20 and subsequent years [$(\$1,384,000 / \$0.13) \times \$0.08$].
- Quantity demanded for compressed natural gas will not decrease significantly as a result of the compressed natural gas tax rate increases.

Assumptions related to the Franchise and Excise tax:

- The estimate of the fiscal impact of the proposed changes to the F&E apportionment formula for Tennessee manufacturers is based on the DOR's static analysis of F&E tax returns for tax periods ending in 2015, adjusted for the anticipated timing of estimated F&E tax payments, and further adjusted for any impact of the Revenue Modernization Act of 2015 that would occur under current law for tax years beginning on or after July 1, 2016, due to the Revenue Modernization Act's change of the apportionment formula from a double-weighted sales factor to a triple-weighted sales factor.
- The Fiscal Review Committee staff does not have access to this data and analysis and cannot independently verify their accuracy.
- The decrease in state revenue to the General Fund is estimated to be: \$30,238,000 in FY16-17; \$102,122,000 in FY17-18; and \$113,300,000 in FY18-19 and subsequent years.

Assumptions related to the sales tax on food and food ingredients:

- Based on sales tax collection data from the three most recent fiscal years (FY13-14, FY14-15, and FY15-16), state sales tax collections derived from the retail sale of food

and food ingredients are estimated to be approximately seven percent of total state sales tax collections.

- The current Fiscal Review Committee estimate for total state sales tax collections in FY17-18 is \$8,940,000,000.
- Local governments are not held harmless from the loss of state-shared sales tax revenue under this bill.
- Pursuant to Tenn. Code Ann. § 67-6-103(a)(3)(A), local governments receive 4.603 percent of state sales tax revenue as state-shared sales tax revenue.
- Pursuant to Tenn. Code Ann. § 67-6-103(c)(2), revenue generated from 0.5 percent of the sales tax rate on the retail sale of food and food ingredients shall be deposited in the state General Fund and earmarked for education purposes.
- Under current law, state sales tax collections derived from the retail sale of food and food ingredients are estimated to be \$625,800,000 ($\$8,940,000,000 \times 7.0\%$) in FY17-18.
- The effective rate of apportionment to local government pursuant to the state-shared allocation is estimated to be 4.1427 percent $[(4.5\% / 5.0\%) \times 4.603\%]$.
- Local revenue pursuant to the state-shared allocation is estimated to be \$25,925,017 ($\$625,800,000 \times 4.1427\%$) in FY17-18. Net state revenue is estimated to be \$599,874,983 ($\$625,800,000 - \$25,925,017$). These numbers are assumed to remain constant in subsequent years under current law.
- State sales tax collections derived from the retail sale of food and food ingredients are estimated to be \$438,060,000 $[(\$625,800,000 / 5.0\%) \times 3.5\%]$ in FY17-18 upon passage of this bill.
- The effective rate of apportionment to local government pursuant to the state-shared allocation is estimated to be 3.9454 percent $[(3.0\% / 3.5\%) \times 4.603\%]$.
- Local revenue pursuant to the state-shared allocation is estimated to be \$17,283,219 ($\$438,060,000 \times 3.9454\%$) in FY17-18. Net state revenue is estimated to be \$420,776,781 ($\$438,060,000 - \$17,283,219$). These numbers are assumed to remain constant in subsequent years under the provisions of this bill.
- The recurring decrease in state sales tax collections derived from the retail sales of food and food ingredients is estimated to be \$179,098,202 ($\$599,874,983 - \$420,776,781$).
- The recurring decrease in local revenue pursuant to the state-shared allocation is estimated to be \$8,641,798 ($\$25,925,017 - \$17,283,219$).

Assumptions related to the Hall Income Tax:

- Pursuant to Tenn. Code Ann. § 67-2-102, the HIT is a five percent tax on income derived from dividends on stock or from interest on bonds.
- Pursuant to Tenn. Code Ann. § 67-2-124, it is the legislative intent that the tax be reduced by one percent annually through enactments of general bills; the tax shall be eliminated for tax years beginning on or after January 1, 2022.
- It is assumed that, under current law, the HIT rate would remain at five percent until it is fully eliminated for tax years that begin on or after January 1, 2022.
- Given the proposed tax change shall be applied to tax years beginning with tax year 2017, and assuming that 100 percent of the HIT owed for tax year 2017 is collected no later than June 30, 2018, the first year impacted by this bill will be FY17-18. This

collection pattern is assumed to remain constant into perpetuity. Therefore, the proposed tax rate decrease will impact each fiscal year FY17-18 through FY21-22, as the HIT will be eliminated for tax years that begin on or after January 1, 2022 (FY22-23 and subsequent years).

- Based on apportionments of HIT collections for the last three fiscal years (FY13-14, FY14-15, and FY15-16), it is estimated that the state retains 65.44 percent of HIT revenue and local governments are apportioned 34.56 percent.
- The current Fiscal Review Committee staff estimate for HIT collections in FY17-18 is \$272,000,000, of which \$177,996,800 is the state portion ($\$272,000,000 \times 65.44\%$), and \$94,003,200 is the local government portion ($\$272,000,000 \times 34.56\%$). These numbers are assumed to remain constant under current law until the tax is fully eliminated in FY22-23.
- The decrease in HIT revenue for the state General Fund is estimated to be: \$35,599,360 in FY17-18 [$\$177,996,800 - (\$272,000,000 / 5.00\% \times 4.00\% \times 65.44\%)$]; \$71,198,720 in FY18-19 [$\$177,996,800 - (\$272,000,000 / 5.00\% \times 3.00\% \times 65.44\%)$]; \$106,798,080 in FY19-20 [$\$177,996,800 - (\$272,000,000 / 5.00\% \times 2.00\% \times 65.44\%)$]; \$142,397,440 in FY20-21 [$\$177,996,800 - (\$272,000,000 / 5.00\% \times 1.00\% \times 65.44\%)$]; and \$177,996,800 in FY21-22.
- The decrease in HIT revenue for the local government is estimated to be \$18,800,640 in FY17-18 [$\$94,003,200 - (\$272,000,000 / 5.00\% \times 4.00\% \times 34.56\%)$]; \$37,601,280 in FY18-19 [$\$94,003,200 - (\$272,000,000 / 5.00\% \times 3.00\% \times 34.56\%)$]; \$56,401,920 in FY19-20 [$\$94,003,200 - (\$272,000,000 / 5.00\% \times 2.00\% \times 34.56\%)$]; \$75,202,560 in FY20-21 [$\$94,003,200 - (\$272,000,000 / 5.00\% \times 1.00\% \times 34.56\%)$]; and \$94,003,200 in FY21-22.

Assumptions related to net revenue impacts and expenditures:

- The total increase in state revenue to the Highway Fund is estimated to be: \$150,663,377 in FY17-18 ($\$33,875,330 + \$250,000 + \$84,728,720 + \$31,468,513 + \$21,429 + \$319,385$); \$195,674,149 in FY18-19 ($\$33,875,330 + \$250,000 + \$105,910,900 + \$55,069,897 + \$35,714 + \$532,308$); and \$240,798,527 in FY19-20 and subsequent years ($\$33,875,330 + \$250,000 + \$127,093,080 + \$78,671,282 + \$57,143 + \$851,692$).
- The total recurring increase in Department of Safety's Motor Vehicle Account, beginning in FY17-18, is estimated to be \$141,000.
- The total decrease in state revenue to the General Fund is estimated to be: \$30,238,000 in FY16-17; \$316,819,562 in FY17-18 ($\$102,122,000 + \$179,098,202 + \$35,599,360$); \$363,596,922 in FY18-19 ($\$113,300,000 + \$179,098,202 + \$71,198,720$); \$399,196,282 in FY19-20 ($\$113,300,000 + \$179,098,202 + \$106,798,080$); \$434,795,642 in FY20-21 ($\$113,300,000 + \$179,098,202 + \$142,397,440$); \$470,395,002 in FY21-22 ($\$113,300,000 + \$179,098,202 + \$177,996,800$); and \$292,398,202 in FY22-23 and subsequent years ($\$113,300,000 + \$179,098,202$).
- The net increase in local government revenue is estimated to be: \$35,938,447 in FY17-18 ($\$52,151,280 + \$11,229,605 - \$8,641,798 - \$18,800,640$); \$38,561,831 in FY18-19 ($\$65,189,100 + \$19,615,809 - \$8,641,798 - \$37,601,280$); \$41,257,214 in FY19-20 ($\$78,226,920 + \$28,074,012 - \$8,641,798 - \$56,401,920$); \$22,456,574 in FY20-21 ($\$78,226,920 + \$28,074,012 - \$8,641,798 - \$75,202,560$); \$3,655,934 in FY21-22

(\$78,226,920 + \$28,074,012 - \$8,641,798 - \$94,003,200); and \$97,659,134 in FY22-23 and subsequent years (\$78,226,920 + \$28,074,012 - \$8,641,798).

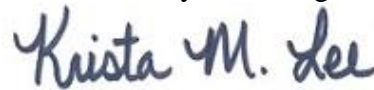
- Any increase in local expenditures to accomplish all of the requirements of the IMPROVE Act is estimated to be not significant.

Assumptions related to the local option transit surcharge and secondary impacts:

- Authorizing local governments, as defined by the IMPROVE Act, to levy a surcharge on the same privileges subject to the taxes specified in the Act, could result in a significant fiscal impact to state and local government. State and local revenue could increase as a result of additional surcharges imposed on taxpayers. State and local expenditures could increase as a result of additional referendum costs and additional tax enforcement and administration requirements.
- Due to multiple unknown factors, such as the number of local governments that will elect to levy a surcharge, the timing of any such levy, the type and magnitude of levied surcharges, and the taxable base for any surcharge, a precise fiscal estimate cannot be determined with reasonable certainty.
- There could be subsequent impacts on state and local government revenue and expenditures as a result of secondary economic impacts prompted by the passage of this bill. Increases in revenue may occur if out-of-state manufacturing businesses relocate their production within state boundaries due to the tax incentives provided by the Act, or if the state's population increases as a result of reduced HIT liability. Increases in expenditures may occur if the demand for governmental programs and infrastructure increases as a result of the Act. Due to multiple unknown factors, the fiscal impacts directly attributable to such secondary economic impacts cannot be quantified with reasonable certainty.
- Some portions of tax savings will be re-spent in the economy on sales-taxable goods and services. Some portions of tax increases would have been spent on sales-taxable goods and services in the absence of this bill. The net impact on state and local revenue of these two effects is estimated to be not significant.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.



Krista M. Lee, Executive Director

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